Nos. 161-162

Supreme Court of the United States

OCTOBER TERM—1941

ESTATE OF CARL LEVIS, DECEASED, HENRY BLUMENTHAL and MANFRED W. EHRICH, EXECUTORS,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

RALPH ROYALL,
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EHRICH, ROYALL, WHEELER & WALTER,
Of Counsel.

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To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

The Estate of Carl Levis, Deceased, Henry Blumenthal and Manfred W. Ehrich, Executors, pray that a Writ of Certiorari issue to review the judgments of the United States Circuit Court of Appeals for the Second Circuit entered in the cases entitled "Commissioner of Internal Revenue, Petitioner, v. Estate of Carl Levis, Deceased, Henry Blumenthal and Manfred W. Ehrich, Executors," on the 21st day of May, 1942, reversing the decisions of the United States Board of Tax Appeals.

OPINIONS BELOW.

The opinion of the Board of Tax Appeals is printed at page 102 of the Record. It is referred to in 42 B. T. A.

at page 1481 as a memorandum opinion but not printed. The opinion of the Circuit Court of Appeals is not yet reported. It is printed at page 126 of the record.

JURISDICTION.

The judgments of the Circuit Court of Appeals were entered on the 21st day of May, 1942. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925, c. 229, Sec. 1, 43 Stat. 938; Sec. 247(a) of Title 228, U. S. C.

THE QUESTION PRESENTED.

The question presented is whether the expenses paid by the taxpayer, Carl Levis, now deceased, for dividends and premiums on borrowed shares of stock in conducting "short" sales of stock as a part of his business of buying and selling securities for his own account, in which business he was actively engaged, are deductible as necessary business expenses from the gross income of such taxpayer for the purpose of determining his net income subject to income tax.

STATUTE INVOLVED.

Revenue Act of 1934, c. 277, sec. 23 (a), 48 Stat. 688.

"Deductions from Gross Income. In computing net income there shall be allowed as deductions:

(a) Expenses.

(1) In general. All the ordinary and necessary expenses paid or incurred during the taxable year

in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity."

STATEMENT.

There were two deficiency assessments of income tax against the taxpayer, one for the year 1936 and the other for the years 1934 and 1935. Since they involved precisely the same question the appeals therefrom were heard and disposed of together in the Board of Tax Appeals as well as in the Circuit Court of Appeals. The Circuit Court of Appeals entered two separate judgments of reversal, the one being on its docket under the number 97 and the other under the number 98 (R. 129, 130).

As found by the Board of Tax Appeals, the taxpayer, "Carl Levis, now deceased, was a member of the New York Stock Exchange during the three taxable years. He was actively engaged during those years in the business of buying and selling securities for his own account. He made a number of short sales during those years in connection with which he borrowed shares for delivery. He agreed with the lender that he would pay to the lender the amount of all dividends which should be paid on all shares until the borrowed shares were returned. He also paid, in some cases, a premium to the lender as a consideration for the

borrowed shares." (Opinion of the Board of Tax Appeals R. 103).

As also stated in the opinion of the Board of Tax Appeals, the Commissioner, in determining the deficiency, disallowed deductions for dividends on borrowed shares, and premiums for the use of borrowed shares (R. 103). The facts were stipulated and the Board of Tax Appeals stated that it adopted the stipulations as its findings of fact (R. 103).

The stipulations of fact, which are printed at pages 34 to 101 of the Record, show not only the facts recited in the opinion of the Board of Tax Appeals, but also show additional details, such as that in the period covered by one of the appeals the taxpayer had made purchases and sales aggregating more than $2,500,000. involving more than 1,000 separate transactions in more than 75 different securities, and that in the other period he had made purchases of more than $4,000,000. and sales of more than $3,900,000. involving more than 600 separate transactions in more than 75 different securities. The stipulations also set out that there were numerous short sales in each of the periods and show the expenses of conducting these short sales transactions, consisting of amounts paid in dividends on borrowed stock, as well as the premiums paid on these transactions. The stipulations agree to the ultimate fact that the taxpayer was "actively engaged in the business of buying and selling securities for his own account during said period" (R. 34, 50). The taxpayer was an active trader in securities, as that phrase was employed in the prevailing opinion of Mr. Justice Douglas in the *DuPont* case (*infra*), and as commonly employed to describe a person conducting the sort of business in which this taxpayer was engaged.

The opinion of the Board of Tax Appeals, in vacating the additional assessments, stated (R. 103):

> "The Circuit Court of Appeals for the Fourth Circuit has held in *Dart* v. *Commissioner,* 74 Fed. 2d. 845 that a taxpayer who is regularly engaged in the business of buying and selling securities for his own account and who makes short sales in connection with that business, may deduct as ordinary and necessary expenses of that business the amounts which he has to pay as dividends on borrowed shares * * * Apparently, the rule of the *Dart* case was approved by the Supreme Court in *Deputy* v. *DuPont,* 308 U. S. 488. It follows that the dividends are deductible here. The same rule would be as applicable in the case of premiums paid for the use of borrowed shares and those also are deductible."

The Circuit Court of Appeals for the Second Circuit reversed the decision of the Board of Tax Appeals. In so doing, it arrived at a result directly contrary to the result arrived at by the Circuit Court of Appeals for the Fourth Circuit in the *Dart* decision. In rendering its opinion, the Circuit Court of Appeals used the following language in referring to the *Dart* case (R. 129):

> "In *Dart* v. *Commissioner,* 74 Fed. 2d. 845, (C.C.A.4), where the seller was a trader, a different result obtained. The *Dart* case was cited in *Deputy* v. *DuPont,* 308 U. S. 488, 495, and the Board relied upon that fact in rendering the decision at bar; but we do not regard such reference by the Supreme Court as an authoritative approval that an active trader in securities may take as ordinary business deductions his carrying charges on short sales."

The case, as it stood before the Board of Tax Appeals and the Circuit Court of Appeals, also involved another question, viz., the right of the taxpayer to deduct as ordinary business expenses some relatively small items of selling commissions which he had paid. After the case was submitted to the Circuit Court of Appeals, but before it was decided, the Supreme Court of the United States handed down its decision in *Spreckles* v. *Helvering* (decided March 16, 1942) 86 L. Ed. 687, Advance Sheet No. 10, which held that selling commissions could not be deducted as ordinary business expenses. This other question was thus disposed of. Therefore, this petition is limited to the question stated at the beginning of this petition as "The Question Presented."

SPECIFICATIONS OF ERROR TO BE URGED.

The Circuit Court of Appeals erred in reversing the Board of Tax Appeals and in holding that the current payments made by the taxpayer for dividends and premiums in carrying short sales as a part of his business of buying and selling securities for his own account, in which business he was actively engaged, could not be deducted by him from his gross income in determining his net income subject to income tax.

REASONS FOR GRANTING THE WRIT.

I

The decision of the Circuit Court of Appeals for the Second Circuit, which petitioners here seek to have reviewed, is directly contrary to the decision of the Circuit

Court of Appeals for the Fourth Circuit in the case of *Dart* v. *Commissioner,* 74 F. 2d. 845. This conflict of decisions between the Second Circuit and the Fourth Circuit is, we submit, a sufficient reason for granting this petition.

II

There are additional reasons why the Supreme Court should review the decision. As appears from the quotation from its opinion contained in the foregoing statement, the Circuit Court of Appeals stated that it did not regard the prevailing opinion written by Mr. Justice Douglas in the case of *Deputy* v. *DuPont* (Jan. 1940) as indicating approval by the Supreme Court of the rule as laid down in the *Dart* decision. The opinion of Mr. Justice Douglas in the *DuPont* case contains the following, (84 L. Ed. 422):

> "Hence, the fact that a particular expense would be an ordinary or common one in the course of one business and so deductible under Section 23 (a) does not necessarily make it such in connection with another business. Thus, it has been held that one who was an active trader in securities might take as deductions carrying charges on short sales since selling short was common in that business."

Here occurs a footnote which reads as follows:

> "*Dart* v. *Commissioner of Internal Revenue,* (C. C. A. 4th) 74 F. (2d) 845. *Cf. Terbell* v. *Commissioner of Internal Revenue,* 29 B. T. A. (F.) 44, affirmed in (C. C. A. 2d) 71 F. (2d) 1017, where such carrying charges were disallowed as deductions. The Board of Tax Appeals said, p. 45, 'We have only the stipulated facts and there is no

> suggestion in those facts that the decedent was engaged in the business of making short sales or in dealing in securities generally.' "

But the Board of Tax Appeals, as shown by one of the quotations from its opinion appearing in our statement above, regarded the above language in the prevailing opinion of the Supreme Court as approving the view of the Circuit Court of Appeals in the *Dart* case. It seems to us that the prevailing opinion of the Supreme Court cannot fairly be regarded in any other light. This is made particularly evident by the reference in the foot-note to that part of the opinion of the Supreme Court to the decision in the case of *Terbell* v. *Commissioner,* 29 B. T. A. 44, which was affirmed without opinion by the Circuit Court of Appeals for the Second Circuit (71 F. 2nd 1017). The prevailing opinion of the Supreme Court at that place points out the difference between the *Dart* case and the *Terbell* case, in that in the one the taxpayer was an active trader, whereas in the other he was not. Nevertheless, the opinion of the Circuit Court of Appeals in the case at bar speaks of its decision herein as in line with its previous decision in the *Terbell* case, while admitting that in the *Terbell* case the taxpayer was not an active trader. Plainly the Court below takes the position that it makes no difference whether or not the taxpayer was an active trader. But it is equally plain that the prevailing opinion of the Supreme Court in the *DuPont* case takes the view that it does make a difference and that, where the taxpayer is an active trader, he may avail himself of the deduction, but that where he is not the opposite is the result.

It is also a fact that the Commissioner of Internal Revenue seems at one time to have acquiesced in the *Dart*

decision, so far as that is evidenced by the fact that the Commissioner refrained from petitioning for a Writ of Certiorari in that case.

All of this is confusing, we submit, to the taxpayers and to the lower courts and to the bar in endeavoring to arrive at a conclusion as to what the law is as to the rights and liabilities of taxpayers in connection with the question here involved and which has been before the Courts in these various decisions.

The matter is further confused by a decision of the Circuit Court of Appeals for the Third Circuit Court in the case of *Helvering* v. *Wilmington Trust Company* (decided September 1941), 124 Fed. 2nd. 156. In that case that Circuit Court of Appeals, writing by Judge Clark, took the view that the taxpayer, although an active trader, could not treat as a deduction, in determining his net income subject to income tax, the current expenses in carrying a short position, stating as the reason for his conclusion that he preferred the view expressed by Mr. Justice Frankfurter in his concurring opinion in the *DuPont* case to the view expressed in the prevailing opinion of the Supreme Court. The view expressed by Mr. Justice Frankfurter is that: "'carrying on any trade or business' within the contemplation of 23 (a) involves holding one's self out to others as engaged in the selling of goods or services." But a reading of the prevailing opinion clearly shows that the view of the Court was different and that, for example, an active trader could avail of the deductions under Section 23 (a). We had always thought that both the bench and the bar were trained to the view that the applicable principle of a decision of the Supreme Court is to be found in the rule as stated in the prevailing opinion of the Court rather than

in the views expressed in some other opinion rendered in the case, even though the latter is a concurring opinion.

That decision of the Circuit Court of Appeals for the Third Circuit was reversed by the Supreme Court in its decision under the title of *Wilmington Trust Company* v. *Helvering,* which decision was rendered on April 27, 1942 (86 Law Ed. 908, Advance Sheet No. 13). Since, however, the reversal by the Supreme Court was on an entirely different ground, it does not help to cure the confusion in which the question is now surrounded.

It seems clear that this confusion can be dispelled by no other means than by the granting of this petition and the making of a decision by the Supreme Court directly upon the question involved.

III

The Court below refers to the decision of the Supreme Court in *Spreckles* v. *Helvering, supra,* and says that "no reason is apparent why expenses incurred in borrowing stock incident to selling short should not be treated the same as selling commissions." But, we submit, that the difference is apparent, for the reason that expenses such as dividends and premiums in carrying a short position are of a current nature and not incident to the closing out of the transaction as is the case of an ordinary selling commission. If a comparison of such a sort were to be made, it could be made with at least equal force to the rule of the *Winmill* case that buying commissions are to be charged to capital cost rather than treated as a deduction under 23a. Such rule was established by this Court in November, 1938 (*Helvering* v. *Winmill,* 305 U. S. 79, 83 L. Ed. 52). The writer of the prevailing opinion of the Supreme Court in

the *DuPont* case must have had the Court's *Winmill* decision in mind and, notwithstanding this, expressed the view above pointed out that an active trader is entitled to deduct under 23a the carrying charges on short accounts. It seems plain to us that the current expenses in carrying a short position stand, for plain reasons, in a different position from either ordinary selling or buying commissions and certainly that this Court's recent decision in the *Spreckles* case cannot be viewed as a new departure in the Court's reasoning in any way inconsistent with the views expressed by the Court in its *DuPont* decision that an active trader would be entitled to deduct under 23a current expenses in carrying a short position.

CONCLUSION.

For the reasons above set forth, it is respectfully submitted that this petition should be granted.

Dated: June, 1942.

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